No. 83-1024

In the Supreme Court of the United States

OCTOBER TERM, 1983

TRIO MANUFACTURING COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether tax accrual workpapers, prepared by an independent auditor of a closely-held corporation not subject to reporting requirements under the federal securities laws, are privileged from disclosure in response to an IRS summons.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A35) is reported at 718 F.2d 1015. The opinion of the district court (Pet. App. C19-C20), adopting the report and recommendation of the magistrate (Pet. App. C1-C18), is not officially reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. B1-B2) was entered on November 3, 1983. The petition for a writ of certiorari was filed on December 20, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner is a closely-held corporation, all of its stock being owned by members of the same family (Pet. App. A3). Because petitioner's shares are not publicly traded, it is not subject to reporting requirements under the federal securities laws (Pet. 5; Pet. App. A29). In 1981, the IRS began an audit of petitioner's 1977-1979 corporate income tax returns. Pursuant to that investigation, the Service issued summonses, under authority of Section 7602 of the Code,[1] to the certified public accountant retained by petitioner to prepare its tax returns and audit its financial statements (Pet. App. A4-A5).[2] (The preparation of audited financial statements by an independent accountant was required by the banks from which petitioner had borrowed money. *Id.* at A5 n.2.) The summonses directed the accountant to produce various documents relating to petitioner's 1977-1979 tax years, including 21 pages of "tax accrual workpapers," *i.e.*, workpapers drafted by the accountant in verifying whether petitioner had reserved a sufficient amount on its books to cover its contingent tax liabilities (*id.* at A5, C26).

The accountant refused to comply with the summonses insofar as they requested production of the tax accrual workpapers (Pet. App. A5-A9). The government petitioned for enforcement in the United States District Court for the Northern District of

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

[2] Section 7602(a)(1) authorizes the Commissioner, "[f]or the purpose of ascertaining the correctness of any return, * * * [t]o examine any books, papers, records, or other data which may be relevant or material to such inquiry."

Georgia (*id.* at C4-C5; I.R.C. § 7604(b)), and petitioner intervened (I.R.C. § 7609(b)). The district court referred the case to a magistrate, and adopted the magistrate's report and recommendation that the summonses be enforced (Pet. App. C1-C20). It found that the summonses had been issued "in good faith" under the standards set forth in *United States* v. *Powell*, 379 U.S. 48, 57-58 (1964) (Pet. App. C10-C14), and that the requested information was "relevant" to the IRS investigation within the meaning of Section 7602 because it "might throw light on the correctness of [petitioner's] return[s]" (Pet. App. C15, citing *United States* v. *Wyatt*, 637 F.2d 293 (5th Cir. 1981)).

The court of appeals unanimously affirmed (Pet. App. A1-A35). It agreed that the tax accrual workpapers were "relevant," rejecting the reasoning of *United States* v. *Coopers & Lybrand*, 413 F. Supp. 942 (D. Colo. 1975), aff'd, 550 F.2d 615 (10th Cir. 1977), which on the facts there presented had denied the relevancy of such documents to an IRS investigation (Pet. App. A20-A22). And it refused to adopt and extend to this case the reasoning of the Second Circuit in *United States* v. *Arthur Young & Co.*, 677 F.2d 211 (1982), cert. granted, No. 82-687 (Feb. 22, 1983), which had concluded that tax accrual workpapers prepared by an independent auditor of a publicly-held corporation are protected by an accountant's work product privilege from disclosure in response to an IRS summons (Pet. App. A22-A29). The court of appeals held that *Arthur Young* was wrongly decided (Pet. App. A26-A28), and that the rationale of that case in any event did not apply to this one. The *Arthur Young* decision, it noted, was "based on a perceived conflict between the federal tax and securi-

ties laws" (Pet. App. A23), a conflict stemming from the fact that the taxpayer was subject to SEC reporting requirements, and from the Second Circuit's concern that IRS access to tax accrual workpapers "would undermine the integrity of the auditing process" to the detriment of the securities markets (*id.* at A24). The court of appeals distinguished *Arthur Young* on that basis, noting that petitioner here "is not subject to the same federal securities laws that were deemed critical to the decision in *Arthur Young*" (*id.* at A29), and holding that this case accordingly did not manifest a "clash between two important congressional policies" sufficient to justify a privilege even on the Second Circuit's reasoning (*id.* at A24).

ARGUMENT

1. The court of appeals correctly held that creation of a federal accountant's work product privilege is unjustifiable. As demonstrated in our brief in *Arthur Young*,[3] this Court and (with the exception of the Second Circuit) the lower federal courts have consistently held that "no confidential accountant-client privilege exists under federal law, and no state-created privilege has been recognized in federal cases." *Couch* v. *United States*, 409 U.S. 322, 335 (1973) (quoted in U.S. Br. at 11, *United States* v. *Arthur Young & Co.*, No. 82-687). These cases reflect the principle that only the weightiest reasons of public policy justify creation of privileges, which limit the admissibility of probative evidence and impair the search for truth (U.S. Br. at 15). The considerations militating against recognizing privileges generally, moreover, have special force when the privilege sought to be created would operate uniquely to obstruct com-

[3] Copies of our brief and reply brief in *Arthur Young* are being sent to petitioner's counsel.

pliance with IRS summonses. As noted below (Pet. App. A28-A29), this Court has held that the Commissioner's summons power should be broadly construed, and should not be restricted "absent unambiguous directions from Congress." *United States* v. *Bisceglia*, 420 U.S. 141, 150 (1975). Thus, for the reasons set forth in our *Arthur Young* brief, petitioner's effort to establish a federal accountant's privilege must be rejected. Accord, *United States* v. *El Paso Co.*, 682 F.2d 530 (5th Cir. 1982), petition for cert. pending, No. 82-716.

2. Regardless of whether *Arthur Young* was correctly decided, however, there is no merit to petitioner's contention (Pet. 15-16) that that decision conflicts with this one. As the court below observed, the rationale of *Arthur Young* has no application here. The summons in *Arthur Young* requested production of tax accrual workpapers prepared by an accountant in auditing the financial statements of a publicly-held corporation and in certifying the accuracy of those statements under the federal securities laws. As the Second Circuit saw the matter, "[t]he verification procedure envisioned by the [Securities] Act requires * * * that management feel free to cooperate with their auditors, and to disclose to them confidential information, such as the questionable positions taken on tax returns" (677 F.2d at 219). It was this perceived "clash between two important congressional policies"—the "national public interest [in] insur[ing] the maintenance of fair and honest [securities] markets" and the public interest in equitable tax collection—that induced the *Arthur Young* court to carve out a qualified privilege for tax accrual workpapers. 677 F.2d at 219-220.

This rationale is wholly absent here because, as petitioner concedes (Pet. 5), it is not a publicly-held corporation and is not subject to any reporting requirements under the federal securities laws. Nor has petitioner pointed to any other conflicting statute or countervailing legislative policy that would, in accordance with the analysis in *Arthur Young*, support the privilege it seeks to establish.[4] At bottom, petitioner contends that an accountant's privilege is justified by its notion of sound public policy. But the Sixth Circuit recently rejected just such an argument, refusing to hold a corporation's internal audit reports privileged from disclosure in response to an IRS summons on analogy with *Arthur Young*, and this Court denied certiorari. *Leaseway Transportation Corp.* v. *United States*, No. 81-3726 (6th Cir. Apr. 19, 1983), cert. denied, No. 83-65 (Nov. 7, 1983).[5]

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[4] Petitioner appears to suggest (Pet. 17-21) that it might at some point in the future make a public offering of stock, and that there thus exists a *potential* conflict with the policies of the securities statutes. But this is just another way of conceding that no actual conflict exists. Nor is there any merit to petitioner's contention (Pet. 21-22) that, wholly apart from the securities laws, there is a "public interest" in the independent auditing process that warrants recognition of an accountant's privilege. Petitioner cites no congressional policy to this effect, and its argument boils down to a contention that the absence of a privilege will impair the candor of accountant-client relations, an argument this Court explicitly rejected in *Couch*.

[5] Although petitioner (see Pet. i) does not seek review of the court of appeals' holding that the tax accrual workpapers were "relevant" within the meaning of Section 7602, it does assert in passing (Pet. 15 n.4) that the Eleventh Circuit's holding in this respect conflicts with the Tenth Circuit's decision in *Coopers & Lybrand*, *supra*. This contention is unfounded. As we have argued in *Arthur Young* (U.S. Reply Br. at 11-16 &

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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n.15), *El Paso* (U.S. Br. at 9-12, *El Paso Co.* v. *United States*, No. 82-716), and *Leaseway Transportation* (Br. in Opp. at 5-7, *Leaseway Transportation Corp.* v. *United States*, No. 83-65), the courts of appeals, including the Tenth Circuit, are unanimous in applying the same legal test to assess the relevancy of material sought by an IRS summons—whether the material "might throw light upon" the correctness of the taxpayer's returns. *E.g.*, *United States* v. *Southwestern Bank & Trust Co.*, 693 F.2d 994, 996 (10th Cir. 1982); *United States* v. *Will*, 671 F.2d 963, 966 (6th Cir. 1982); *United States* v. *Noall*, 587 F.2d 123, 125-126 (2d Cir. 1978), cert. denied, 441 U.S. 923 (1979). (Copies of our briefs in *El Paso* and *Leaseway Transportation* are being sent to petitioner's counsel.) The *Coopers & Lybrand* court, in declining to enforce a summons for tax accrual workpapers on relevancy grounds, stated that such issues "must be [decided] on an ad hoc basis" (550 F.2d at 620) and rested its holding largely on the factual findings made by the district court.

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